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COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

AT RICHMOND, JANUARY 14, 2003

APPLICATION OF

VIRGINIA GAS DISTRIBUTION COMPANY

CASE NO. PUE-2001-00357

For an Annual Informational  
Filing

ORDER ADOPTING RECOMMENDATIONS  
AND DISMISSING PROCEEDING

On January 22, 2002, Virginia Gas Distribution Company ("VGDC" or the "Company"), by counsel, filed a motion with the State Corporation Commission ("Commission") to request additional time in which to file its Annual Informational Filing ("AIF") for 2001. In that motion, VGDC noted that the Commission had previously granted an extension for the Company to file its AIF for 2001, but asserted that it required a further extension to May 31, 2002, to gather the appropriate information for filing this AIF.

In its January 25, 2002 Order Granting Further Extension, among other things, the Commission directed VGDC to file its 2001 AIF using the test period January 1, 2001, through September 30, 2001, for all of its AIF schedules with the exception of Schedules 9, 10, and 12, no later than May 31,

2002. The Company was also directed to file by May 31, 2002, Schedules 9, 10, and 12, using the twelve months ending September 30, 2001, as the test period for these Schedules.

On May 3, 2002, the Company, by counsel, filed a motion requesting a waiver of Rule 20 VAC 5-200-30 A 9, requiring the filing of Schedules 9 through 14, and that part of Schedule 21 (Workpapers for Earnings Test and Ratemaking Adjustments) related to the foregoing Schedules. In support of its motion, VGDC stated that Schedules 9 through 14 address the Company's earnings test and regulatory assets and that the Company had no regulatory assets or capitalized interest subject to the earnings test required by these Schedules.

On May 10, 2002, the Commission granted a waiver of Rule 20 VAC 5-200-30 A 9 and directed that VGDC could omit Schedules 9 through 14, and that portion of Schedule 21, relating to the omitted schedules, from its AIF for the test year ending September 30, 2001.

On June 7, 2002, VGDC, by counsel, filed a motion requesting that its 2001 AIF delivered to the Commission on June 5, 2002, be accepted out of time. The Company explained that it was unable to file its AIF on May 31, 2002, because of extenuating family circumstances experienced by its regulatory compliance officer.

On June 14, 2002, the Commission granted VGDC's motion and accepted the Company's 2001 AIF out of time, subject to a review of the documents accompanying the application for completeness in accordance with the requirements of the Commission's Rules Governing Utility Rate Increase Applications and Annual Informational Filings ("Rate Case Rules"). The Company's application was determined to be complete on June 11, 2002.

On November 22, 2002, the Staff filed its audit report in the captioned matter, which included a financial and accounting analysis. In its report, Staff noted that it had used an 11.5% cost of equity in VGDC's capital structure since the Company does not have an authorized point or range for its return on equity. Staff explained that the lack of actual operating data made it necessary for the Company to base its application for a certificate of public convenience and necessity, docketed as Case No. PUE-1993-00013, on the rates derived from its estimate of revenues and costs.

Staff reported that VGDC filed an application for its first rate increase in August 1999, in Case No. PUE-1999-00531. VGDC elected not to seek an authorized return on equity which would have supported a higher rate increase than it requested in its application. The February 22, 2000 Order entered in Case No. PUE-1999-00531 permitted VGDC's proposed rate increase to take effect on January 23, 2000, under the terms of the Joint

Stipulation reached between the Company and Staff. The Joint Stipulation specifically provided that no authorized return on equity range would be identified as part of that case.

In its report, the Staff supported the use of NUI Corporation's ("NUI's") capital structure for purposes of the captioned AIF. NUI was the company that acquired Virginia Gas Company ("VGC"), VGDC's former parent, and VGDC. Staff explained that it generally supports the use of the capital structure of the entity that raises debt capital in capital markets because the entity raising capital is subject to market constraints and scrutiny. With NUI's acquisition of VGC and VGDC, NUI became the entity that supplied capital to VGDC. Staff therefore used NUI's ratemaking capital structure for its report and determined that the consolidated NUI ratemaking capital structure has an equity ratio of 36.973% and produces a cost of capital of 7.69% for the test year. For comparative purposes, the Staff noted that the consolidated NUI ratemaking capital structure was not significantly different from the consolidated VGC capital structure, which had an equity ratio of 35.54% and produced an overall cost of capital of 7.557%. Staff further commented that VGDC should file Schedules 1, 2, and 3, in any future AIF consistent with the Commission's Rate Case Rules by including information for the test year and four prior fiscal years.

In its accounting analysis, Staff reported that it had corrected several of VGDC's accounting adjustments. Staff noted that the Commission had issued an Order, docketed as Case No. PUA-2001-00041, on September 6, 2002, approving a comprehensive affiliates agreement between VGDC, VGC, Virginia Gas Storage Company ("VGSC") and Virginia Gas Pipeline Company. During the test year, the costs associated with that agreement were not distributed. Since the Commission's September 6, 2002 Order was issued at the end of the Company's pro forma year, Staff did not make any adjustments to the Company's cost of service for these expenses. Staff recommended that the Company reflect adjustments to the cost of service and rate base that incorporate the distribution of costs specified in the September 6, 2002 Order entered in Case No. PUA-2001-00041, in its next AIF or rate application.

Staff also proposed that the Company be required to write off capitalized interest booked in excess of the methodology agreed upon by Staff and Company in Case No. PUE-1998-00325. This methodology addressed the treatment of capitalized interest in rate base. Staff and Company had agreed, consistent with that methodology, that any interest capitalized on the Company's books in excess of the agreed upon methodology would be removed from rate base. Staff recommended that the Commission authorize

the Company to write off excess capitalized interest from the books that the Company maintains for regulatory purposes.

By letter filed January 7, 2003, VGDC, by counsel, advised that it did not desire to respond to the Staff report.

NOW UPON consideration of the Company's application, the Staff report, and the applicable statutes, the Commission is of the opinion and finds that the Staff's recommendations found in its November 22, 2002 report should be adopted, and that this application should be dismissed from the Commission's docket of active proceedings.

Accordingly, IT IS ORDERED THAT:

(1) Consistent with the findings made herein, the recommendations set out in the Staff's November 22, 2002 report are hereby adopted.

(2) VGDC shall file Schedules 1, 2, and 3 in any future AIF consistent with the Commission's Rate Case Rules by including information for the test year and the four prior fiscal years.

(3) The Company shall write off interest capitalized in excess of the amounts of interest capitalized in the Company's rate base in accordance with the agreed upon methodology delineated in Case No. PUE-1998-00325 from the books that the Company maintains for regulatory purposes.

(4) VGDC shall reflect adjustments to its cost of service and rate base that incorporate the distribution of costs specified in the September 6, 2002 Order entered in Case No. PUA-2001-00041, in the Company's next AIF or rate application.

(5) There being nothing further to be done in this proceeding, this application shall be dismissed from the Commission's docket of active proceedings, and the papers filed herein placed in the Commission's file for ended causes.